THE STATE OF NEW HAMPSHIRE
SUPREME COURT

Docket No. 2004-785

Verizon New England, Inc.,
d/b/a Verizon New Hampshire

APPEAL FROM PUBLIC UTILITIES COMMISSION

BRIEF FOR THE OFFICE OF CONSUMER ADVOCATE

THE OFFICE OF CONSUMER ADVOCATE

F. Anne Ross
Consumer Advocate

Rorie E.P. Hollenberg
Staff Attorney

21 S. Fruit St., Ste. 18
Concord, N.H. 03301
(603) 271-1172

July 5, 2005

(15 Minutes)

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES

CONSTITUTIONAL, STATUTES, RULES

MISCELLANOUS

QUESTIONS PRESENTED FOR REVIEW

I. Whether the New Hampshire Public Utilities Commission (Commission) acted in a lawful, just and reasonable manner when it determined that an affiliate services contract between a regulated subsidiary and an unregulated subsidiary of Verizon Communications, Inc., was unjust and unreasonable, as the contract required the regulated subsidiary to transfer value to the unregulated subsidiary without compensation.

II. Whether the Commission acted in a lawful, just and reasonable manner when it imputed revenues for ratemaking purposes between regulated and unregulated subsidiaries of Verizon Communications, Inc., in response to an unjust and unreasonable affiliate services contract between the two subsidiaries and pursuant to its authority to make such reasonable order relating thereto as the public good requires.

III. Whether the Commission acted in a lawful, just and reasonable manner when it imposed a fine of $1000 for Verizon New Hampshire's failure to file an affiliate services contract amendment as required by law.

STATEMENT OF THE CASE

The Office of Consumer Advocate (OCA) hereby incorporates by reference the Statement of the Case of Appellee, the Commission.

STATEMENT OF FACTS

The OCA hereby incorporates by reference the Statement of the Facts of Appellee, the Commission.

SUMMARY OF THE ARGUMENT

At the heart of this case are issues concerning the Commission's regulation of affiliate contracts between regulated and unregulated subsidiaries of a common corporate parent, Verizon Communications, Inc. (Verizon), and the Commission's plenary authority to rectify the consequences of an unreasonable and unjust affiliate contract. In pertinent part, on January 1, 1999, Verizon New Hampshire (Telephone Company), the regulated subsidiary, changed its affiliate services contracts with Verizon Yellow Pages Company (Directory Company), its unregulated affiliate. While the Directory Company retained the right to publish the Telephone Company's white pages under the new directory publishing agreements and continued to enjoy the value of its association with the Telephone Company and the Telephone Company's good reputation, the revenue sharing arrangements associated with this value transfer were improperly eliminated. This change - for which the Telephone Company provided no reasonable explanation - essentially reversed a regulatory policy of revenue sharing which had been in place in New Hampshire for at least 15 years.

The Telephone Company failed to sustain its burden of proof below. This necessitated a determination by the Commission that the terms of the affiliate services agreement for 2000 were unjust and unreasonable as well as the imputation of revenues from the Directory Company to the affiliate Telephone Company for purposes of ratemaking.

On Appeal, the Appellants failed to sustain their burden of proof that the Commission's order is contrary to the law, unjust or unreasonable. Consequently, the Court should dismiss their appeal and affirm the Commission's order.

ARGUMENT

I. THE COMMISION ACTED IN A LAWFUL, JUST AND REASONABLE MANNER WHEN IT DETERMINED THAT AN AFFILIATE SERVICES CONTRACT BETWEEN A REGULATED SUBSIDIARY AND AN UNREGULATED SUBSIDIARY OF VERIZON COMMUNICATIONS, INC., WAS UNJUST AND UNREASONABLE, AS THE CONTRACT REQUIRED THE REGULATED SUBSIDIARY TO TRANSFER VALUE TO THE UNREGULATED SUBSIDIARY WITHOUT COMPENSATION.

A. The Commission's Scrutiny Over Utility Affiliate Transactions is Broadly Defined

Regulated utilities have a long history of utilizing affiliates to provide services and to sell products to them.[1] Regulators have a correspondingly long history of attempting to prevent the excessive diversion of regulated revenues and assets to unregulated affiliates.[2] Recent notorious examples of inappropriate inter-affiliate transactions are those Enron arranged shortly before its collapse in 2001.[3] As Enron clearly demonstrated:

> [W]henever a company conducts transactions among its own affiliates there are inherent issues about the fairness and motivations of such transactions … One concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial

---

[1] *See* Judy Sheldrew, Shutting The Barn Door Before The Horse Is Stolen: How And Why State Public Utility Commissions Should Regulate Transactions Between A Public Utility And Its Affiliates, 4 Nev. L.J. 164, 164-165 (Fall 2003) (citation omitted).

[2] *See Id*. *See also* 47 C.F.R. 32.27, OCA Appendix at 31-33 (the Federal Communications Commission's rules requiring telephone utilities to purchase services from unregulated affiliates at the lesser of cost or market price and to sell services to unregulated affiliates at the greater of cost or market price).

[3] *See* Staff of Senate Comm. on Gov't Affairs, 107th Cong., Committee Staff Investigation of the Federal Energy Regulatory Commission's Oversight of Enron Corp., at 2 (Nov. 12, 2002) (explaining that on December 2, 2001, Enron, then the nation's seventh largest company, filed for bankruptcy protection amid allegations of financial and other fraud. Enron's collapse left thousands unemployed, erased billions of dollars of shareholder value and triggered crises, not only in investor confidence in U.S. financial markets, but in consumer and investor confidence in the energy markets as well.).

> burdens. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.[4]

Since affiliates such as the Telephone Company and the Directory Company are owned by a common parent, Verizon, they are operated for the benefit of that common parent and not as independent entities. Verizon has no incentive to maximize the profits of its regulated subsidiary, the Telephone Company, since excess profits will only result in lower rates over the long run and, correspondingly, lower profits to the parent company. On the other hand, there is every financial incentive for Verizon to operate its unregulated subsidiaries, including the Directory Company, in order to maximize their profits which are not limited by regulation.

Because of affiliates' ownership by a common parent, affiliate contracts are not "made at arm's length or on an open market. As a result, they are subject to suspicion and present dangerous potentialities.[5] Affiliate transactions, including those involving a utility affiliate, can take many forms. The myriad of different forms chosen by affiliates should not prevent regulators, or courts, from addressing the economic consequences of those transactions. "[I]t does not matter … whether the utility [pays an] affiliate too much money for too little service or property, or whether …the utility [gives an] affiliate something of far greater value than the affiliate paid for in return. The effect in either situation is to give to the shareholders of the affiliate something of value at the expense of the ratepayers of the utility."[6]

---

[4] Staff of Senate Comm. On Gov't Affairs, 107th Cong., Committee Staff Investigation of the Federal Energy Regulatory Commission's Oversight of Enron Corp., at 26 and fn. 75 (Nov. 12, 2002).

[5] Pac. Tel & Tel. Co. v. Pub. Utils. Comm'n, 215 P.2d 441, 449 (Cal. 1950) (Carter, J., dissenting). *See also* Appellant's Appendix to Appeal at 74-75 ("the general rationale for the Commission's authority to review transactions between affiliated companies is fear of collusion in the absence of arm's-length dealings.").

[6] *See* Appellant's Appendix to Appeal at 74-75.

On account of the suspect nature of affiliate transactions, New Hampshire law authorizes the Commission to give them special scrutiny.[7] In reviewing an affiliate arrangement, the Commission is obliged to look beyond the legal forms employed by affiliates under the control of a common corporate owner and also to consider the true character of the arrangement as it relates to the central question of whether the arrangement is "unjust or unreasonable."[8]

The process by which the Commission scrutinizes the justness and reasonableness of public utility affiliate contracts is spelled out in broad terms. Public utilities must file with the Commission "*any* contract or arrangement and … *any* modification thereof … entered into between a public utility and an affiliate[9] providing for the furnishing of …services … by an affiliate" to the public utility.[10] The time period prescribed for such a filing is "within 10 days after the date on which the contract is executed or the arrangement entered into."[11]

---

[7] *See* RSA chapter 366, Appellant's Appendix to Appeal at 190-198.

[8] *See* RSA 366:5, Appellant's Appendix to Appeal at 194.

[9] An affiliate is defined by RSA 366:1, II (1992), Appellant's Appendix to Appeal at 190, as:

> (a) Any person that directly or indirectly owns, controls, or holds with power to vote a majority of the outstanding voting securities or such minority thereof as to give him substantial control of such a public utility.
>
> (b) Every person who the commission may determine as a matter of fact, after investigation and hearing, is either directly or indirectly through intermediate persons, or otherwise, actually exercising any substantial influence over the policies and actions of a public utility, whether or not in conjunction with one or more persons.
>
> (c) Any person with whom a public utility has a management or service contract or arrangement of the character set forth in RSA 366:3, but not including contracts for personal services with persons not otherwise affiliated.
>
> (d) Any person that is directly or indirectly owned, controlled or held by any person described in subparagraph (a) of this paragraph through either power to vote a majority of the outstanding voting securities, or such a minority so as to maintain substantial control.

[10] RSA 366:3 (1933) (emphasis added), Appellant's Appendix to Appeal at 192. Further, "[t]he commission may also require a public utility to file in such form as the commission may require full information with respect to any purchase from or sale to an affiliate, whether or not made in pursuance of a continuing contract or arrangement." *Id*.

[11] *Id*.

The Commission has "*full power and authority* to investigate *any* [affiliate] contract."[12] "In any such investigation, the burden shall be on the public utility and affiliate to prove the reasonableness of … such contract."[13] Moreover, the utility and the affiliate are required to cooperate with the Commission's investigation.[14]

In determining whether an affiliate contract is unjust or unreasonable, there is no "formulaic principle."[15] In doing so, the Commission "must exercise a measure of discretion"[16] and "be the arbiter between the interests of the customer and the interests of the regulated utilities."[17] The Court has recognized that "discretionary choices of policy necessarily affect such decisions, and that the legislature has entrusted such policy to 'the informed judgment of the Commission, and not to the preferences of reviewing courts.'"[18]

On appeal, the party seeking to set aside the Commission's order bears the burden of proof to show by a preponderance of the evidence that the Commission's order is contrary to the law, unjust or unreasonable.[19] The Commission's findings of fact are "deemed prima facie

---

[12] RSA 366:5 (1933) (emphasis added), Appellant's Appendix to Appeal at 194.

[13] *Id*.

[14] *Id*. ("If in any such investigation the public utility or affiliate shall unreasonably refuse to comply with *any request* of the commission for information with respect to relevant accounts and transaction under investigation, so that such parts thereof as the commission may deem material may be made part of the record, such refusal shall justify the commission in disapproving the transaction under investigation and disallowing payments in pursuance thereof.") (emphasis added); and RSA 366:9 (1933), Appellant's Appendix to Appeal at 198 ("The commission may also require such other information as to the direct or indirect control of a public utility or affiliate *from a public utility, affiliate, or other person* as may be reasonably required for the effective enforcement of this chapter.") (emphasis added).

[15] Re PSNH Proposed Restructuring Settlement, 85 N.H. PUC 154, 241 (2000) (re determination of public interest).

[16] Re Concord Electric Company, 87 N.H. PUC 595, 606-607 (2002) (re determination of public interest); *see* Permian Basin Area Rate Cases, 390 U.S. 747, 792 (1968) (The legislature has entrusted discretionary choices of policy to "the informed judgment of the Commission, and not to the preferences of reviewing courts.").

[17] N.H. RSA 363:17-a (1979), OCA Appendix at 34.

[18] Appeal of Conservation Law Foundation of New England, Inc, 127 N.H. 606, 616 (1986), *citing* Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968).

[19] N.H. RSA 541:13 (1937), Appellant's Appendix to Brief at 189.

lawful and reasonable."[20] Simply put, the Court will not substitute its judgment for that of the Commission.[21]

B. The Commission Correctly Found Based on the Record that the 2000 DPA was Unjust and Unreasonable.

On March 8, 2000, the Telephone Company filed with the Commission revised affiliate services contracts with the Directory Company, including a Directory Publishing Agreement (2000 DPA).[22] According to the terms of the 2000 DPA, the Directory Company agreed to fulfill the Telephone Company's regulatory obligations with respect to the publishing and distribution of telephone directories[23] to the Telephone Company's customers[24] and the Directory Company was authorized to "sell advertising in any section of the Telephone Directories."[25] The Telephone Company, however, was granted "no rights or interest in any revenues received by [the Directory Company] in connection with the sale or other marketing of Directory Advertising."[26] This was a significant departure from earlier Yellow Pages publishing

[20] *Id.*

[21] *See* Appeal of Peirce, 122 N.H. 762, 764 (1982), *citing* Appeal of Concord Natural Gas Corp., 121 N.H. 685, 692 (1981).

[22] *See* Appellant's Appendix to Appeal at 293-303. There is no dispute that the Telephone Company is a public utility and that the Directory Company is an affiliate of a public utility for purposes of RSA 366, as were their predecessors. *See* Appellant's Appendix to Appeal at 5, fn. 4.

[23] See Appellant's Appendix to Appeal at 231-232 (telephone directories were defined as including both White Pages and Yellow Pages).

[24] *See* Appellant's Appendix to Appeal at 294.

[25] Appellant's Appendix to Appeal at 295.

[26] *Id.* "[The Telephone Company] continued to receive revenues from [the Directory Company] for providing subscriber listing information under a standard Listings License Agreement between [the Telephone Company] and [the Directory Company] dated as of January 1, 2000 (2000 LLA) as well as for billing and collection services rendered to [the Directory Company]." *See* Appellant's Appendix to Appeal at 5, fn. 5.

agreements filed with the Commission,[27] a change that the Commission ultimately found to be "unjust and unreasonable."[28]

Before reaching its conclusion that the 2000 DPA was unjust and unreasonable, the Commission examined the events and circumstances preceding the 2000 DPA. Before 1984,[29] the Telephone Company published the white and yellow page directories distributed within its telephone service territory.[30] "During this time, the revenues and costs related to telephone directories, including Yellow Pages, were reflected in [the Telephone Company's] New Hampshire revenue requirement and directory assets were included in rate base.[31] As a result of this arrangement, the Telephone Company ratepayers paid all costs associated with the directory publishing and Yellow Page operations and retained all of the profits.

At least by the early 1980s, the Telephone Company's Yellow Pages operations were "highly profitable[,]"[32] earning "supra-competitive" profits.[33] The "Yellow Pages provided a large 'subsidy' to local telephone rates …and the loss of the 'subsidy' was predicted to result in large rate increases."[34] For this reason, the Telephone Company retained the right to print

---

[27] *See* Appellant's Appendix to Appeal at 87-88 (describing the terms of the 1984 DPA) and 97-99 (describing the terms of the 1991 DLA). Although the Telephone Company and Directory Company entered into an amendment to the 1991 DLA, known as the 1999 Amendment, this agreement was never filed with the Commission as required. *See* Appellant's Appendix to Appeal at 101-102.

[28] Appellant's Appendix to Appeal at 115-116. *See* RSA 366:5 (1933), Appellant's Appendix to Appeal at 194.

[29] *See* Appellant's Appendix to Appeal at 83 (for "more than one hundred years").

[30] *See* Appellant's Appendix to Appeal at 83 and 109. *See also* Transcript Day 1 at 150.

[31] Appellant's Appendix to Appeal at 84. *See also* Appellant's Appendix to Appeal at 6, *citing* Kevin O'Quinn Rebuttal Testimony at 5.

[32] Appellant's Appendix to Appeal at 85.

[33] *Id*. *citing* United States v. American Telephone and Telegraph Company, 552 F. Supp. 131, 193 (D.D.C. 1982), *aff'd sub nom*. Maryland v. United States, 460 U.S. 1001 (1983).

[34] Appellant's Appendix to Appeal at 86, *citing* United States v. American Telephone & Telegraph Company, 552 F. Supp. at 194 (loss of the Yellow Pages subsidy "could reduce the number of homes with telephones and increase the disparity, in terms of the availability of telephone service, between low

Yellow Pages directories after the breakup of the AT&T monopoly.[35] "In effect, the [AT&T decision] recognized the value of the Yellow Pages enterprise to the [Telephone Company] and established [its] rights to the revenues derived from the Yellow Pages business subject to supervision and regulation by the states."[36]

In 1984, in the wake of the divesture process of AT&T, the Telephone Company transferred its Yellow Pages operations to an affiliate, the Directory Company.[37] The "Yellow Pages business was a legacy of the monopoly position of the regulated telephone company" and "in 1984 [the Directory Company] inherited an established Yellow Pages business developed by [the Telephone Company], a business so successful it was earning 'supra competitive' profits."[38] "Trained and knowledgeable [Telephone Company] Yellow Pages employees were moved to [the Directory Company], together with established customer relationships and business strategies, among other assets."[39] The Telephone Company made this transfer with the

---

income and well-off citizens, a result 'clearly contrary to the goal of providing affordable telephone service to all Americans.'").

[35] Appellant's Appendix to Appeal at 85-86, *citing* United States v. American Telephone & Telegraph Company, 552 F. Supp. at 189-190, 193-194.

[36] Appellant's Appendix to Appeal at 86. *See also* Re New England Telephone & Telegraph Company, Inc., 73 N.H. PUC 390 (1988) (Commission authorized the Telephone Company to expand its marketing of White Pages to third parties and found that "the revenues from such marketing efforts will contribute toward the public good by diminishing the revenue burden on local rates" consistent with previous rulings minimizing local rates by inclusion of directory revenues in the Telephone Company's revenue requirement.).

[37] *See* Appellant's Appendix to Appeal at 6, and 50-51. The commission found that this transfer was not permanent, that the telephone company did not thereby permanently relinquish to the directory company its right to contribution from yellow pages operations, and that the telephone company was not paid full value for such a permanent transfer or relinquishment. *See* Appellant's Appendix to Appeal at 96 and 107.

[38] Appellant's Appendix to Appeal at 85 (citations omitted) and 108.

[39] Appellant's Appendix to Appeal at 108. *See* Transcript Day 1 at 186-187.

expectation that the Yellow Pages operations of the Directory Company would "[continue] the contribution to basic telephone service."[40]

Also at this time, the Telephone Company filed the first of several affiliate services contracts with the Directory Company for the publishing of its required white pages, the 1984 Directory Publishing Agreement (1984 DPA).[41] In the 1984 DPA the Directory Company agreed to publish and distribute the white pages that the Telephone Company was required to provide to its customers.[42]

The 1984 DPA remained in effect for seven years, from January 1, 1984 through December 31, 1990, when it was superseded by a new publishing agreement, the 1991 Directory Listing Agreement (1991 DLA).[43] Like the 1984 DPA, the 1991 DLA granted the Directory Company the right to bundle its Yellow Pages advertising with the Telephone Company's required white pages.[44] The 1991 DLA remained in effect through 1998.[45]

Both the 1984 DPA and the 1991 DLA provided a mechanism for revenue sharing payments by the Directory Company to the Telephone Company.[46] Accordingly, revenue sharing payments to the Telephone Company were accounted for in the Telephone Company's

---

[40] Appellant's Appendix to Brief at 69.

[41] *See* Appellant's Appendix to Appeal at 86-87. See also Appellant's Appendix to Appeal at 227-271.

[42] *See* N.H. Code Admin. Rules Puc 405.04, Appellant's Appendix to Appeal at 206. *See also* Appellant's Appendix to Appeal at 97 ("[the Telephone Company] represented to the Commission in 1984 … that the [1984 DPA was] for the purpose of producing and publishing directories *for* [the Telephone Company]") (emphasis in original).

[43] *See* Appellant's Appendix to Appeal at 7, 97, and 272-290. *See also* Appellant's Appendix to Appeal at 96 ("[the Telephone Company] represented to the Commission in … 1991 that the [1991 DLA was] for the purpose of producing and publishing directories *for* [the Telephone Company]") (emphasis in original).

[44] Appellant's Appendix to Appeal at 273-274; and 275-281.

[45] Appellant's Appendix to Appeal at 101 (1991 DLA in effect until 1999 Amendment).

[46] Appellant's Appendix to Appeal at 87 (describing the terms of the revenue sharing under 1984 DPA) and 248-253; and 98 (describing terms of the 1991 DLA) and 290.

regulated books of account as "above the line" revenues.[47] These reported revenues were "net of the expenses [the Directory Company] incurred in conducting Yellow Pages operations."[48] The revenue sharing arrangements left some profits with the Directory Company and transferred the excess profits to the Telephone Company.

Generally speaking, "[a]side from the revenues retained by [the Directory Company], the revenue impact for both [the Telephone Company] and ratepayers [under the 1984 DPA and 1991 DLA] was not fundamentally different from that existing before 1984 when Yellow Pages operations were conducted directly by [the Telephone Company]."[49] The consideration exchanged for the revenue sharing payments was in part the right of the Directory Company to publish directories for the Telephone Company and distribute its Yellow Pages advertising in the process.

On January 1, 1999, the Telephone Company and the Directory Company began operating under an amendment to the 1991 DLA.[50] According to the 1999 Amendment and the subsequent publishing agreement, the 2000 DPA, the Directory Company continued to enjoy the right to publish directories for the Telephone Company and bundle them with its Yellow Pages.[51]

---

[47] Appellant's Appendix to Appeal at 97.

[48] Appellant's Appendix to Appeal at 97.

[49] *Id*. *See also* Appellant's Appendix to Appeal at 6 ("Parties and Staff also agreed that the revenues paid to the Telephone Company after 1983 under the directory publishing agreements described below were also included in the regulated books" of the Telephone Company.).

[50] *See* Appellant's Appendix to Appeal at 101, and 291-292. Although the Appellants argue that the termination of the 1991 DPA was reasonable, this argument misses the point. The Commission did not find that the termination of the 1991 DPA was unreasonable, rather the Commission found that the 2000 DPA was unreasonable because it failed to continue revenue sharing

[51] *See Id*. *See also* Appellant's Appendix at 97-98 (describing terms of the 1991 DLA) and 104-105 (describing terms of the 2000 DPA).

Moreover, as it had done since 1984, the Directory Company continued to enjoy "supra profits"[52] and reap the benefits of the reputation of the Telephone Company for permanence, circulation and reliability,[53] a reputation "supported by the rates charged consumers" of the Telephone Company.[54] Under the 1999 Amendment, however, the revenue sharing payments from the Directory Company to the Telephone Company abruptly ended.[55] These payments would not be reinstated by the successor publishing agreement between the affiliates, the 2000 DPA.[56]

Even though the 1999 Amendment and the 2000 DPA did not use the word "exclusive" to describe the Directory Company's and Telephone Company's undertakings,[57] "for practical purposes, the publishing and advertising arrangement between them [remained] an exclusive one."[58] Only one directory publisher is needed to provide the tariffed directory service and the

---

[52] *See* United States v. American Telephone & Telegraph Company, 552 F. Supp. at 193. *See also* Appellant's Appendix to Appeal at 46 (for example, in 2002 and 2003, there was both revenue growth and sustained profitability in the neighborhood of 50% of gross revenues); and 129 (payments to the Telephone Company during the 1995-1998 period from Yellow Pages directory advertising profits averaged $23 million per year).

[53] Appellant's Appendix to Appeal at 109-110, 111. *See also* Appellant's Appendix to Appeal at 56-57.

[54] Appellant's Appendix to Appeal at 110. *See also* Appellant's Appendix to Appeal at 58.

[55] *See* Appellant's Appendix to Appeal at 101. *See also* Appellant's Appendix to Appeal at 8-9.

[56] *See* Appellant's Appendix to Appeal at 101 and 105. *See also* Appellant's Appendix to Appeal at 115 ("Under the 2000 DPA, [the Telephone Company] does not presently garner any value from the Yellow Pages operations.").

[57] *Compare* Appellant's Appendix to Appeal at 6 ("[the Telephone Company] characterized the 1984 DPA as one in which, in return for a grant by [the Telephone Company] to [the Directory Company] of 'the exclusive right of the Telephone Company during the term of [the contract] to contact subscribers of the [Telephone Company], and all others, for the purposes of soliciting and obtaining, Directory Advertising to appear in all Telephone Directories published hereunder[.]'"); and 7 ("according to the terms of the 1991 DLA, [the Telephone Company] granted [the Directory Company] a 'nontransferable and exclusive license … for the term of the Agreement to: (i) use the Telephone Company's name in soliciting Directory Advertising; (ii) use the Telephone Company's name, slogans and marks in publishing and distributing Telephone Directories; and (iii) designate the Telephone Directories as the 'official' directories of the Telephone Company.").

[58] *See* Appellant's Appendix to Appeal at 114 ("No evidence was introduced that [the Telephone Company] is prepared to launch a new publishing and advertising venture, that [the Telephone Company] ever considered offering to independent publishers a publishing arrangement as an alternative to the 1991 DLA or the 2000 DPA, or that having two companies in an enterprise under common control might make economic sense for the enterprise as a whole."). *See also* Appellant's Appendix to Appeal at 43.

Telephone Company has assigned that regulatory duty to its publishing affiliate. As a practical matter, only the Directory Company may claim that it is affiliated with the Telephone Company when it solicits Yellow Pages advertising from the Telephone Company's customers. Further, only the directory advertising being sold by the Directory Company will be included in the directory that the Telephone Company provides to all of its telephone customers. Whether the Directory Company *needs*[59] anything more from the Telephone Company to publish its directories is beside the point; the Directory Company *gets* value from the Telephone Company over and above other directory publishers who only receive subscriber listings.[60]

The Commission estimated the value lost to the Telephone Company under the 2000 DPA at $23.3 million annually based upon the earlier revenue sharing formula which allowed a reasonable profit to the Directory Company and transferred the excess profit to the Telephone Company.[61] To put the magnitude of that excess profit in perspective, the Telephone Company's annual regulated intrastate revenues in New Hampshire during 1999 were approximately $341 million.[62]

In effect, the "2000 DPA does not secure for the benefit of ratepayers any of the value of the Yellow Pages business opportunity, the right to contribution, or the association between [the Telephone Company] and [the Directory Company]; rather the value flows entirely to the benefit

---

[59] *See* Appellant's Brief at 4 ("the Directory Company had everything it needed to publish telephone directories"); and 23 ("the Directory Company needed nothing further from the Telephone Company"). *See also* Appellant's Appendix to Appeal at 169-170 (the Telephone Company "maintains that beyond its subscriber listings for which it is compensated, it has nothing of value that [the Directory Company] needs to conduct its directory publishing business"); and 175 (the Telephone Company "reiterates that [it] owns no assets today that are needed by [the Directory Company] to conduct its business").

[60] *See* Appellant's Brief at 24.

[61] *See* Appellant's Appendix to Appeal at 129.

[62] *See* Telephone Company's Response to OCA Data Request 1-7, "Earnings Statement Twelve Months Ended December 1999," dated April 13, 2000; OCA Appendix at 39.

of shareholders."[63] This financial result for ratepayers "is inconsistent with the result of an arms length transaction and, to the extent it affects the interests of New Hampshire ratepayers, [the Telephone Company's] entry into the 2000 DPA arguably constitutes imprudent management."[64]

Moreover, the Directory Company did not develop its directory advertising business by its own initiative, skill, investment or risk-taking in a competitive market.[65] It inherited this business from the entity that was the sole provider of local telephone service, and which owned the underlying customer databases and had established business relationships with virtually all of the potential advertisers in the Yellow Pages. The Directory Company continues to enjoy a unique and direct benefit by being associated with the Telephone Company's regulated telecommunications services which justifies the payment to the Telephone Company of a portion of the revenues enjoyed by the Directory Company.

The "[t]elephone directories, including both White Pages and Yellow Pages, [have been] commonly viewed as integral to providing telecommunications services to ratepayers."[66] The

---

[63] Appellant's Appendix to Appeal at 115.

[64] Appellant's Appendix to Appeal at 115. *See also* Appellant's Appendix to Appeal at 107-111 (discussion of why the 2000 DPA is inconsistent with the result of an arm's length transaction and the value of the association between the Telephone Company and the Directory Company).

[65] *See* Transcript Day 2 at 44-45. *See also* Appellant's Appendix to Appeal at 65 ("the Yellow Pages market has likely been non-competitive for well over a decade"); and 66 ("the lower bound of [the Directory Company's] market share in New Hampshire is 70% based on the number of distributed directories").

[66] Appellant's Appendix to Appeal at 84, *citing* Re US West Communications, Inc., 165 P.U.R.4th 235 (Utah P.S.C. Nov 6, 1995) (No. 95-049-05); US West Communications, Inc. v. Public Service Commission of Utah**,** 998 P.2d 247, 250-251 (Utah 2000); State Utilities Commission v. Southern Bell Telephone & Telegraph Company, 307 N.C. 541, 299 S.E.2d 763, 766 (N.C. 1983); Re New England Telephone & Telegraph Company, 62 P.U.R.4th 503 (Vt.P.S.B. Oct 5, 1984) (Nos. 4874/4875); Re New England Telephone and Telegraph Company, 157 P.U.R.4th 112 (Vt.P.S.B. Oct 5, 1994) (Nos. 5700/5702); Re Cincinnati Bell Telephone Company, 190 P.U.R.4th 585 (Ky.P.Se.C. Jan 25, 1999) (Case No. 98-292); Re Pacific Northwest Bell Telephone Company dba US West Communications, 110 P.U.R.4th 132 (Or.P.U.C. Dec 29, 1989) (Order No. 89-1807); Re Pacific Bell, Decision 02-10-020, PUR Slip Copy, 2002 WL 31398657 (Ca.P.U.C. Oct 3, 2002). *See also* Transcript Day 2 at 40-41 (The

"right to contribution arising from [the Yellow pages business opportunity] still inure to the benefit of the regulated telephone company and in turn its ratepayers"[67] and "there has been and there continues to be significant value flowing to the [Directory Company] … derived from its association with [the Telephone Company … for which the [Telephone Company] and its ratepayers deserve to be compensated."[68]

As the Commission concluded, "such compensation is earned by [the Telephone Company] and its successors.[69] As such, it follows that these ratepayers "deserve to obtain their fair share of this value"[70] and "[the Telephone Company did not, nor could it unilaterally relinquish on its behalf, or on behalf of ratepayers, the value derived from Yellow Pages publication nor the right to contribution arising from such opportunity, both by the factual

---

Telephone Company conceded that telephone directories are a very useful and beneficial component in providing basic telephone service to the public). *See also* Appellant's Appendix to Appeal at 183 (The Telephone Company did not challenge the propriety of the long-standing practice of including directory assets in rate base and costs and revenues from Yellow Pages operations as "above the line" items reflected in the regulated telephone company's revenue requirement or provide any evidence that the experience in New Hampshire regarding the close connection between telephone service and telephone directories is significantly different than elsewhere in the United States.)

[67] Appellant's Appendix to Appeal at 107. *See also* Appellant's Appendix to Appeal at 108 ("[The Telephone Company] has not proved that the value of the advantages and benefits granted in the past by [the Telephone Company]to [the Directory Company] was fully paid on a current basis during the term of the 1984 DPA and the 1991 DLA so that no further compensation is owed for advantages and benefits granted in the past or due in the future."); and 115 ("we find that the Yellow Pages business opportunity and the right to contribution in connection with such opportunity should continue to inure to the benefit of [the Telephone Company's] ratepayers for regulatory purposes").

[68] Appellant's Appendix to Appeal at 107-108.

[69] Appellant's Appendix to Appeal at 108 (emphasis added).

[70] *Id*. *See also* Appellant's Appendix at 112 ("the value of concern to us in this docket is not the value of the [Verizon] name and logo as such, but the value of what the name is identified with, i.e., the regulated telephone company and its reputation."); and 114, *citing* Re Pacific Northwest Bell Telephone Company dba US West Communications, 110 P.U.R. 4th 132 (Or.P.U.C. Dec 29, 1989) (Order No 89-1807) ("the thing of value which … makes these Yellow Pages different and much more valuable than others, is their connection with the local exchange telephone company, no matter what its name happens to be. The local exchange company is the long-time permanent resident of the community which provides the local service. The distribution of the classified advertising with the necessary white pages by, with the blessing of, or in association with the local exchange company sets them apart from any other classified advertising efforts.").

history of the transaction and as a matter of law."[71] Given that RSA 366:5 makes it clear that the utility has the burden of proving that an affiliate contract is just and reasonable, the Telephone Company needs to do more than repeatedly claim that there is no value to the Directory Company being the only publisher contracting to print the Telephone Company's white pages and to combine and distribute those white pages with the Directory Company's Yellow Pages.[72]

In this case the Commission determined, based upon an extensive record, that the Telephone Company's regulated telephone customer base gave a unique value to the Yellow Pages publishing arrangement with the Directory Company. That value allowed the Directory Company to retain a 70% market share of the yellow pages publishing business[73] and further allowed the Directory Company to charge more the twice the rates for its yellow page advertising than did independent directory publishing companies.[74] Based upon the record, the Commission's conclusion that the 2000 DPA was "unjust and unreasonable"[75] is consistent with the law, and is just and reasonable.

[71] Appellant's Appendix to Appeal at 106-107.
[72] *See* Appellant's Appendix at 115 ("[The Telephone Company] has not provided us with any citations to authority demonstrating that the 2000 DPA is reasonable or that comparable agreements have been found to be reasonable in other jurisdictions." and "[the Telephone Company] has not met its burden of proof under RSA 366:5 regarding the justness and reasonableness of the 2000 DPA.")
[73] *See* Appellant's Appendix to Appeal at 66.
[74] *See* Attachment 3.2 to pre-filed reply testimony of Chris Schlegel, Exhibit 48, OCA Appendix at 42-44.
[75] Appellant's Appendix to Appeal at 115-116. *See also* Appellant's Appendix to Appeal at 168.

C. Section 222 (e) of the 1996 Telecommunications Act Does Not Prohibit Revenue Sharing in Publication Arrangements such as the 2000 DPA

The Telephone Company argues that section 222 (e) of the TAct of 1996[76] prevents it from sharing revenue with the Directory Company under the 2000 DPA. This argument misses the point of section 222 (e) which provides, **"…** a telecommunications carrier that provides telephone exchange service *shall provide subscriber list information* gathered in its capacity as a provider of such service on a timely and unbundled basis, under nondiscriminatory and reasonable rates, terms and conditions, to any person upon request for the purpose of publishing directories in any format." Section 222(e) does not address publishing arrangements nor does it prohibit revenue sharing.[77] Section 222(e) merely deals with the Telephone Company's obligations to share subscriber listings information on equal terms.[78]

Section 222 (e) addresses subscriber list information and clearly applies to the 2000 Listing License Agreement and not the Directory Publishing Agreement as acknowledged by the Telephone Company in its March 8, 2000, letter to the Commission.[79] The Commission was correct in concluding that section 222(e) does not prohibit revenue sharing as part of publishing arrangements such as the 2000 DPA[80]

[76] 47 U.S.C Section 222(e) (2001), Appellant's Appendix to Appeal at 210.
[77] *See* Appellant's Appendix to Appeal at 131.
[78] *Id.*
[79] OCA Appendix at 45. The letter also states that the 2000 LLA and associated listings letter were developed to comply with new regulatory requirements, and in particular TAct section 222(e) (Subscriber List Information); the 2000 DPA is not mentioned in this regard.
[80] *See* Appellant's Appendix to Appeal at 131.

II. THE COMMISSION ACTED IN A LAWFUL, JUST AND REASONABLE MANNER WHEN IT IMPUTED REVENUES FOR RATEMAKING PURPOSES BETWEEN REGULATED AND UNREGULATED SUBSIDIARIES OF VERIZON COMMUNICATIONS, INC., IN RESPONSE TO AN UNJUST AND UNREASONABLE AFFILIATE SERVICES CONTRACT BETWEEN THE TWO SUBSIDIARIES AND PURSUANT TO ITS AUTHORITY TO MAKE SUCH REASONABLE ORDER RELATING THERETO AS THE PUBLIC GOOD REQUIRES.

RSA 366:5 grants the Commission authority to impose the remedy of imputation. The language of this statute is broad in scope, granting the Commission the authority to fashion a remedy for an unjust or unreasonable affiliate contract *as the public good requires*."[81]

The Commission's authority to address unjust or unreasonable affiliate contracts is not limited to the specific remedies listed in RSA 366:5, 366:6 and 366:7. These non-exclusive remedies include "disapprov[ing] the [contract] and disallow[ing] payments thereunder or … part of any payment,"[82] "apply[ing] to the superior court for an order directing the public utility to cease making any such payment or doing such other thing,"[83] or "disallow[ing] the inclusion in the accounts of a public utility of any payments or arrangements to an affiliate for any services rendered, or property furnished."[84] The Commission, however, may otherwise address the unjustness or unreasonableness of the affiliate contract even without an express statutory remedy.[85]

---

[81] RSA 366:5 (1933) (emphasis added), Appellant's Appendix to Appeal at 194.

[82] *Id*. Further, "[n]o payment disallowed by the commission shall be capitalized or included as an operating cost of the public utility in the fixing of rates or as an asset in fixing a rate base." *Id*.

[83] RSA 366:6 (1933), Appellant's Appendix to Appeal at 195.

[84] RSA 366:7 (1933), Appellant's Appendix to Appeal at 196. This statute applies to contracts or arrangements existing on the effective date of Laws of 1933, Ch. 182, namely, June 19, 1933.

[85] *See* Appeal of Reid, 143 N.H. 246, 252 (1998) ("all of the words of a statute must be given effect and that the legislature is presumed not to have used superfluous or redundant words.").

The Commission, "generally ha[s] the implied or incidental powers reasonably necessary to carry out the powers expressly granted to [it]" by the Legislature.[86] "[W]ithout a doubt the [commission] may not go beyond the words of the statute properly construed, but they must be read in the light of its general purpose and applied with a view to effectuate such purpose."[87]

The purpose of RSA chapter 366 is to insure that affiliate contracts with regulated utilities are just and reasonable.[88] That purpose, taken together with the Commission's duty to be the arbiter between the interests of the ratepayer and the interests of the regulated utilities,[89] certainly includes recasting the financial implications of affiliate contracts when they are unfair to the customers of a regulated utility. In fact, the statute allows the Commission to review and issue such orders concerning any affiliate contract "as the public good requires."[90]

Although RSA chapter 366 does not expressly describe the remedy of imputation, such a remedy allows the unregulated affiliate to continue its contractual relationship while still correcting the unreasonable and unjust financial outcome of the arrangement for ratemaking purposes. Other states have found that similar statutory language allows the remedy of imputation of revenues from publishing affiliates to incumbent telephone carriers.[91]

---

[86] Appeal of JAMAR, 145 N.H. 152, 155 (2000) (citation omitted) ("because the legislature cannot anticipate all of the problems incidental to the carrying out of administrative duties, administrative entities generally have the implied or incidental powers reasonably necessary to carry out the powers expressly granted to them."); and Appeal of Public Service Co. of New Hampshire, 122 N.H. 1062, 1066 (1982) *citing* Petition of Boston & Maine Railroad, 82 N.H. 116, 116, 129 A. 880, 880 (1925) ("The PUC is a creation of the legislature and as such is endowed with only the powers and authority which are expressly granted or fairly implied by statute.").

[87] Fed. Trade Comm'n v. W. Meat Co., 272 U.S. 554, 559 (1926). *See also* Appeal of Granite State Electric Company, 120 N.H. 536, 539 (1980) (citations omitted)(Commission was established to provide comprehensive provisions for the establishment and control of public utilities in the State and it must not only perform duties statutorily created but also must exercise those powers inherent within its broad grant of power).

[88] RSA 366:5 (1933), Appellant's Appendix to Appeal at 194.

[89] RSA 363:17-a. (1979), OCA Appendix at 34.

[90] RSA 366:5 (1933), Appellant's Appendix to Appeal at 194.

[91] *See* US West Communications, Inc. v. Washington Utilities & Transportation Comm., 949 P.2d 1337, 1348 (1998). *See also* Appellant's Appendix to Appeal at 123-126.

"Imputation is a narrowly tailored remedy which avoids potential disruptions to [the Telephone Company] and the policies of other states from the possible extra-territorial effect of a Commission order disapproving the 2000 DPA in its entirety."[92] Imputation makes ratepayers whole and is consistent with the "public good."[93] In effect, "[i]mputation accomplishes nothing more than what the companies have done for many years."[94]

Imputation is also consistent with the Commission's general rate setting authority provided in RSA 378:7 (1951).[95] RSA 378:7[96] provides:

> Whenever the commission shall be of opinion, after a hearing had upon its own motion or upon complaint, that the rates, fares or charges demanded or collected, or proposed to be demanded or collected, by any public utility for service rendered or to be rendered are unjust or unreasonable, or that the regulations or *practices of such public utility affecting such rates are unjust or unreasonable*, or in any wise in violation of any provision of law, or that the maximum rates, fares or charges chargeable by any such public utility are insufficient, the commission shall determine the just and reasonable or lawful rates, fares and charges to be thereafter observed and in force as the maximum to be charged for the service to be performed, and shall fix the same by order to be served upon all public utilities by which such rates, fares and charges are thereafter to be observed. The commission shall be under no obligation to investigate any rate matter which it has investigated within a period of 2 years, but may do so within said period at its discretion.

(emphasis added). The Commission has considerable discretion in setting rates, and is not bound by law to the service of any single formula or a combination of formulas.[97]

---

[92] Appellant's Appendix to Appeal at 116.

[93] *Id*. *See also* RSA 366:5 (1933), Appellant's Appendix to Appeal at 194.

[94] Appellant's Appendix to Appeal at 116.

[95] *See* Appellant's Appendix to Appeal at 120 *citing* Legislative Utility Consumers' Council v. Public Service Co., 119 N.H. 332, 339-340 (1979) and US West Communications, Inc. v. Washington Utilities & Transportation Commission, 949 P.2d at 1346.

[96] OCA Appendix to Brief at 47.

[97] *See* Appellant's Appendix to Appeal *citing* New England Telephone & Telegraph Co. v. State, 95 N.H. 353 (1949); and Chicopee Mfg. Co. v. Public Service Co., 98 N.H. 5 (1953) (the dominant standard of New Hampshire statutes is that rates shall be just and reasonable.) *See also* Appellant's Appendix to Appeal at 76 *citing* Campaign for Ratepayers Rights, 145 N.H. 671 (2001) ("[t]he Constitution is only concerned with the end result of a rate order.").

The new contractual arrangements between the Telephone Company and the Directory Company are an "unjust or unreasonable" "practice" which directly impacts rates. RSA 378:7 authorizes the Commission to respond by determining the "just and reasonable" rates of the Telephone Company. Imputation is a necessary remedy to achieve that result, is well within the full power and authority of the Commission to order and has been applied often in setting rates.[98]

The Commission reasoned that the value contributed by the Telephone Company should be compensated by the Directory Company and therefore ordered an imputation of revenues from the Directory Company to the Telephone Company.[99] The amount of that imputation was set initially at $23.3 million[100] and the Commission ordered that a subsequent proceeding be opened to determine the appropriate amount of the imputation.[101]

The remedy of imputation allows the parent, Verizon, to continue to receive and report for tax and non-regulatory accounting purposes the $23.3 million annual profits of the Directory Company, but attributes those profits to the Telephone Company for rate making purposes. It is a bookkeeping change and does not require that any funds actually be diverted or "confiscated" from the Directory Company. Instead, for ratemaking purposes, the Telephone Company will report additional revenues, initially in the annual amount of $23.3 million and, following a subsequent proceeding, at whatever level the Commission determines is appropriate.

---

[98] *See* Appellant's Appendix to Appeal at 74 *citing* New England Telephone & Telegraph Co. v. State, 98 N.H. 211 (1953) (approved use of imputed capital structure rather than actual capital structure in determining cost of capital) and Granite State Telephone, Inc., 73 N.H. PUC 152, Order No. 19,057 (April, 1988) (when determining tax expenses, the tax calculation was performed using an imputed interest deduction to give the ratepayers the benefit of a portion of the investment tax credit.).

[99] *See* Appellant's Appendix to Appeal at 127.

[100] *See* Appellant's Appendix to Appeal at 129. *See also* Appellant's Appendix to Appeal at 169.

[101] *See* Appellant's Appendix to Appeal at 127-128. *See also* Appellant's Appendix to Appeal at 169.

The Telephone Company has not demonstrated how imputation is unfair or harmful to either the Telephone Company or the Directory Company. To the contrary, the Telephone Company confirmed that "[w]hether that [Yellow Pages] net income was on the books of [the Telephone Company] as Staff is recommending in this case, or it's on the books of [the Directory Company], that matters little to the net income that's reported to our shareholders."[102]

The high profitability of the Directory Company[103] as well as the market power[104] demonstrated by its ability to charge almost twice the yellow page advertising prices of its independent competitors[105] provide a reasonable basis for the Commission to assign significant value to the Telephone Company's customer base and to surmise that in an arms length transaction an independent publisher would be willing to pay the Telephone Company a portion of its revenues in order to obtain the publishing rights for the Telephone Company's white pages.

---

[102] Transcript Day 4 at 165.

[103] *See* Appellant's Appendix to Appeal at 46 (for example, in 2002 and 2003, there was both revenue growth and sustained profitability in the neighborhood of 50% of gross revenues); and 129 (payments to the Telephone Company during the 1995-1998 period from Yellow Pages directory advertising profits averaged $23 million per year).

[104] *See* Appellant's Appendix to Appeal at 65 ("the Yellow Pages market has likely been non-competitive for well over a decade"); 66 ("the lower bound of [the Directory Company's] market share in New Hampshire is 70% based on the number of distributed directories"); 69 ("the market in which Yellow Pages directories compete do not have the competitive characteristics" and the Telephone Company "has presented no information regarding whether the level of competition in the Yellow Pages business has materially changed since the 1980s."); and 70 ("buyers of directories expect the businesses to continue producing strong and growing profits for many years and do not expect a significant risk of margin erosion from competition of any sort" and "return on investment in the directory business of more than 100 percent is a powerful indicator of the lack of competition").

[105] *See* Appellant's Appendix to Appeal at 67.

III. THE COMMISSION ACTED IN A LAWFUL, JUST AND REASONABLE MANNER WHEN IT IMPOSED A FINE OF $1000 FOR VERIZON NEW HAMPSHIRE'S FAILURE TO FILE AN AFFILIATE SERVICES CONTRACT AMENDMENT AS REQUIRED BY LAW.

The OCA hereby incorporates by reference argument III of the Appellee, the Commission.

CONCLUSION

For the foregoing reasons, the Office of Consumer Advocate respectfully requests that this Honorable Court affirm the judgment below. The Office of Consumer Advocate requests to be heard orally.

Respectfully submitted,
THE OFFICE OF CONSUMER ADVOCATE
By the Consumer Advocate,

F. Anne Ross
Consumer Advocate

Rorie E.P. Hollenberg
Staff Attorney

21 S. Fruit St., Ste. 18
Concord, N.H. 03301
(603) 271-1172

_____, 2005

I hereby certify that two copies of the foregoing were mailed this day, postage prepaid, to all parties listed on the attached Service List.

F. Anne Ross

OCA APPENDIX